INDEX

CITATIONS

In the Supreme Court of the United States

October Term, 1940

No. 105

Union Trust Company of Indianapolis as Former Executor of the Last Will and Testament of William H. Block, Deceased, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 88–94) is reported in 39 B. T. A. 338. The opinion of the Circuit Court of Appeals (R. 110–114) is reported in 111 F. (2d) 60.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 27, 1940. (R. 115.) The petition for a writ of certiorari was filed on May 27, 1940. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether an estate is subject to income tax for the year 1932 on a refund of federal estate taxes received during that year, when the taxes refunded had been claimed and allowed as a deduction from the gross income of the estate for 1929, 1930, and 1931, the years in which the estate taxes were paid.

2. Whether amounts payable annually to beneficiaries of a testamentary trust are allowable deductions from the gross income of the estate, where the payments do not depend exclusively upon trust income.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) GENERAL DEFINITION.—"Gross income" includes * * * gains or profits and income derived from any source whatever. * * *
>
> (b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this title;
>
> * * * * *
>
> (3) GIFTS, BEQUESTS, AND DEVISES.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);
>
> * * * * *

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, * * *, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. * * *

STATEMENT

The pertinent facts, as stipulated (R. 18–23) and as found by the Board of Tax Appeals (R. 89–94), may be summarized as follows:

1. The decedent died on December 11, 1928, a resident of Indiana. The executor of his estate paid federal estate taxes as follows (R. 89):

December 11, 1929	$564,299.23
July 1, 1930	14,992.00
January 15, 1931	233,859.15

Deductions were claimed by the estate for the above amounts on the income tax returns of the estate for the appropriate years. The deductions were allowed. The statute of limitations has now run against any additional assessments of income tax for those years. (R. 89–90.)

The amount of the tax paid was computed after deducting a credit for the amount of state inheritance tax which was due under the laws of Indiana as they existed prior to March 6, 1931. The laws of Indiana were amended on that day to increase retroactively the state inheritance tax due upon estates, including the estate of this decedent. Pursuant to this amendment, the estate paid, on June 16, 1932, an additional state inheritance tax of $611,228.58. That amount was claimed and allowed as a deduction from income of the estate for 1932, the year here involved. (R. 90.)

In the meantime, a proceeding was instituted before the Commissioner for redetermination of the federal estate tax because of the increased liability to the State of Indiana. By stipulation before the Board, petitioner was allowed full credit for the additional inheritance tax due the state and, as a result, petitioner received a refund of $603,983.25 on October 12, 1932. (R. 90.)

The estate kept its books and made its returns upon a cash receipts and disbursements basis. In filing its income tax return for 1932, it did not include in gross income the $603,983.25 received by way of refund. The Commissioner, in determining the deficiency, included this amount in gross income. (R. 89–90.)

2. The testator in his will directed the trustees to pay $50,000 per annum from the net income of his estate to his wife, the annual payment to decrease as the estate was distributed. (R. 25.) The tes-

tator also directed (R. 27–28) that several annuities be paid from the income of his estate. With regard to the operation of the estate, Item III, section F, of the will stated (R. 31):

> 1. All payments hereinbefore directed to be made from the income of my residuary estate, shall be made in monthly installments, unless expressly otherwise provided, and except the payments of residuary income to my sons, Meier, Rudolph and Edward, shall begin within one month following my death. Prior to the time such residuary estate is turned over to my Trustees, such payments shall be made by my Executor, and in case at any time, either before or after said residuary estate comes into the hands of said Trustees, there shall not be sufficient income to make such payments, such deficiency shall be made up by pledging a part of the corpus of my estate; such pledge to be discharged from future income, as and when income in sufficient amounts is realized.

The estate's income tax return for 1932 deducted $105,583.34, which was the sum of the annuities referred to above. The Commissioner disallowed this deduction. (R. 23.)

3. The Board of Tax Appeals held (1) that the refund received in 1932 was subject to income tax in that year; and (2) that the payments to the beneficiaries were annuities and not distributions of income and, consequently, were not deductible from the income of the estate. Accordingly it de-

termined that there was a deficiency in income tax for 1932 in the amount of $49,798.74. (R. 92, 94–95.) The court below affirmed. (R. 115.)

ARGUMENT

1. The decision below that the refund of federal estate taxes in 1932 was income taxable to petitioner for that year is clearly correct and accords with settled principles. The refunded taxes were properly paid in 1929, 1930 and 1931 and, consequently, were properly deducted from the income of the estate during those years. Petitioner became entitled to a refund only in 1932, when the increased state inheritance tax was paid. In these circumstances, the refund constituted income when made. *Houbigant, Inc.* v. *Commissioner,* 31 B. T. A. 954, affirmed, 80 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 298 U. S. 669; *Nash* v. *Commissioner,* 88 F. (2d) 477 (C. C. A. 7th), certiorari denied, 301 U. S. 700; *Commissioner* v. *Central United National Bank,* 99 F. (2d) 568 (C. C. A. 6th); *Universal, Inc.* v. *Commissioner,* 109 F. (2d) 616 (C. C. A. 7th); *Victoria Paper Mills Co.* v. *Commissioner,* 32 B. T. A. 666, affirmed, 83 F. (2d) 1022 (C. C. A. 2d); *cf. Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359; *United States* v. *White Dental Co.,* 274 U. S. 398, 403; *Helvering* v. *Midland Mutual Life Insurance Co.,* 300 U. S. 216; *Brown* v. *Helvering,* 291 U. S. 193; *North American Oil* v. *Burnet,* 286 U. S. 417, 424.

The same principle has been applied by the Circuit Courts of Appeals in many analogous situations. Thus, debts charged off as worthless constitute income if they are subsequently recovered. *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776 (C. C. A. 2d); *Putnam Nat. Bank* v. *Commissioner,* 50 F. (2d) 158 (C. C. A. 5th); *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. (2d) 320, 325 (C. C. A. 6th); *Carr* v. *Commissioner,* 28 F. (2d) 551 (C. C. A. 5th). Assessments paid to a State Depositors' Guaranty Fund originally deducted are treated as income when later returned. *Wichita State Bank & T. Co.* v. *Commissioner,* 69 F. (2d) 595 (C. C. A. 5th), certiorari denied, 293 U. S. 562. An award by the Mixed Claims Commission on account of property confiscated by Germany is regarded as income, where deductions had been taken in the year of confiscation. *Automobile Ins. Co.* v. *Commissioner,* 72 F. (2d) 265 (C. C. A. 2d); *Marine Transport Co.* v. *Commissioner,* 77 F. (2d) 177 (C. C. A. 5th). Cf. *Cooper* v. *United States,* 9 F. (2d) 216, 223–224 (C. C. A. 8th). A check given for valid obligations when issued, but uncashed at the end of two years and credited to profit and loss, constitutes income. *Chicago R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. (2d) 990 (C. C. A. 7th), certiorari denied, 284 U. S. 618.

Neither *Inland Products Co.* v. *Blair,* 31 F. (2d) 867 (C. C. A. 4th), nor *Leach* v. *Commissioner,* 50 F. (2d) 371 (C. C. A. 1st) is inconsistent with the decision below. In those cases the returns for the

earlier years were still open and before the Commissioner and the courts. See *Chevy Chase Land Co.* v. *Commissioner,* 34 B. T. A. 150, 153. Consequently, two methods of treating the refund were available: correction of the earlier return or addition to gross income in the later year. The courts in the *Inland Products* and *Leach* cases held that the former method was preferable, since it placed the parties in the position which they would have occupied had there been no mistake of law in the original payment of the tax. But those cases did not hold that that method of treating the refund is the only admissible one. Indeed, the decision in the *Inland Products* case, which was followed in the *Leach* case, was careful to reserve the question as to what the result would be where the statute of limitations had run on the earlier years. In the present case, as distinguished from the *Inland Products* and *Leach* cases, the deductions were correctly computed and allowed in the years claimed; no case involving those years was pending when the refund was received and no additional assessment could have been made for 1929, the year in which most of the estate tax was paid, since the statute of limitations had run before the refund was made. Assessments were also barred for the other years before the petition in the present case was filed with the Board. Whatever might be the result where the earlier years are open, it remains true that under correct accounting and legal prin-

ciples it is permissible to treat the refund as income when received. See cases cited *supra,* p. 6.

It should be noted that the *Inland Products* and *Leach* cases were strongly relied upon in the petitions for certiorari in *Houbigant* v. *Commissioner, supra,* and *Nash* v. *Commissioner, supra,* but in both cases the writ was denied. 298 U. S. 669; 301 U. S. 700. There is no valid distinction between the present case and the *Houbigant* and *Nash* cases.

2. The decision of the court below that the distributions to the beneficiaries under the testamentary trust were payments of annuities and therefore not deductible by the estate is likewise correct and in accordance with the applicable decisions of this Court. An annuity is a bequest payable in any event, and, if necessary, from the corpus. Such an annuity is not taxable to the recipient (*Burnet* v. *Whitehouse,* 283 U. S. 148), and cannot be deducted by the trustee, even though it is paid out of income. *Helvering* v. *Butterworth,* 290 U. S. 365, 370–371. And the same rule applies even though provision be made in the will for the restoration of the corpus from later income in the event that any of the corpus is used to pay the annuity. *Duncan* v. *Commissioner,* 34 B. T. A. 999, affirmed, 91 F. (2d) 1012 (C. C. A. 2d), certiorari denied, 302 U. S. 752.

The present case falls squarely within the principle established by these decisions. The decedent directed that the annuity should be paid out of trust income, but if the income was insufficient the deficiency was to be made up by pledging a part of

the corpus as security for a loan, which was to be repaid from future income (R. 31). Under this testamentary scheme, it is clear that the annuities were not dependent upon the realization of income, but were payable in any event and, if necessary, the payments were to be a charge upon the corpus. In these circumstances, the distributions, even though actually made from income, are not deductible. *Helvering* v. *Butterworth, supra; Boston Safe Deposit & Trust Co.* v. *Commissioner,* 66 F. (2d) 179 (C. C. A. 1st), certiorari denied, 290 U. S. 700; *Warner* v. *Commissioner,* 66 F. (2d) 403 (C. C. A. 2d), certiorari denied, 290 U. S. 688.

CONCLUSION

The decision below is correct and presents no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
LOUISE FOSTER,
Special Assistants to the Attorney General.
RICHARD H. DEMUTH,
Special Attorney.

JUNE, 1940.

U. S. GOVERNMENT PRINTING OFFICE: 1940